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SUBJECT: INVESTMENT CLIMATE STATEMENT, 2007 - MALDIVES

REF: 2006 State 178303

¶1. Per reftel, below is the investment climate statement for Maldives for 2007.

INVESTMENT CLIMATE STATEMENT-MALDIVES

FEBRUARY 2007

Investment Climate

--Introduction

Maldives is comprised of over 1,190 islands, of which 198 are inhabited and 87 are exclusive resort islands. Population is about 350,000, while over 600,000 tourists arrive annually. The capital, Male?, has a population of 103,000. GDP in 2006 totaled about \$900 million, or about \$3,000 per capita (exceeding the average of about \$700 in the rest of South Asia). Over the past decade, real GDP growth averaged over 7.5 percent per year except for 2005, when GDP declined following the Indian Ocean tsunami. Economic growth has been powered mainly by tourism and its spin-offs in transportation, communication, and construction. While income disparity remains high, this growth also resulted in considerable social progress. The net enrollment in primary education is close to 100 percent. Literacy rates are about 98 percent. Infant and maternal mortality are declining rapidly.

The Indian Ocean tsunami in December 2004 devastated many islands, with damage estimated at \$450 million. Yet the Maldivian economy has made a remarkable recovery from the tsunami. A rebound in tourism, development of new resorts,

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and post-tsunami reconstruction helped increase GDP by nearly 18 percent in 2006 following a contraction of 4.5 percent in 2005.

Growth is expected to continue in 2007 at a rate of over 10 percent, fueled by tsunami reconstruction, new resort construction and government services. Inflation has

moderated to about 3 percent from over 6 percent in 2004-2005. The trade deficit has expanded sharply in recent years as a result of high oil prices and imports of construction material. In 2006, the trade deficit reached an estimated \$600 million. However, as tourism recovered and government borrowing increased, the balance of payments recorded a surplus of about \$40 million in 2006 from a deficit of \$17 million in 2005.

Government spending has increased sharply due to tsunami reconstruction and increased social and capital investment. Government expenditure was estimated at 75 percent of GDP in 2006 compared to 36 percent of GDP in 2004 before the tsunami. Government expenditure is set to rise further to

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92 percent of GDP in 2007. The budget deficit was 18 percent of GDP in 2006 and will increase sharply in 2007 as a result of this increased expenditure. Government revenue comes mainly from tourism and import tariffs. The government hopes to borrow from banks and resort operators to meet the 2007 deficit. However, the government needs to return to fiscal prudence quickly to ensure future economic stability.

Maldives ranked 53 out of 175 countries in the World Bank's (www.worldbank.org) Ease of Doing Business 2007 Index, ahead of its South Asian neighbors. The index investigates regulations that enhance or constrain business activity. Within the index, Maldives ranked first in terms of paying taxes (Maldives has no income or sales tax), fifth in employing workers, and ninth in dealing with licenses. But in terms of registering property, getting credit, and closing a business, the country ranked lower, at 172, 143, and 114, respectively. Other ranks were as follows: starting a business 31, protecting investors 60, trading across borders 91, and enforcing contracts 83.

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According to the World Bank, Maldives will "graduate" from Least Developed Country (LDC) status in 2011. Maldives' major economic challenge beyond LDC graduation is how to diversify the economy beyond tourism and fisheries. Tourism will likely remain the engine of the economy. Over 40 new resorts are expected to open in the next five years. The government hopes to expand existing airports and build new ones to cater to increased tourism. Other plans include increasing capacity of ports. The government is pursuing the establishment of a major transshipment port serving Indian Ocean sea lanes adjacent to the northern Maldives.

The United Nations Development Program (UNDP) www.mv.undp.org, the Asian Development Bank (ADB) www.adb.org, and other multilateral and bilateral donors are active in Maldives. They support government efforts to improve basic infrastructure, promote economic diversification, modernize education, create employment opportunities, and spur development. The United States has friendly relations with Maldives. To further enhance engagement with the United States, the Government of Maldives plans to open a diplomatic mission with a trade office in Washington D.C. in early 2007.

--Openness to Foreign Investment

Foreign investment in Maldives is governed by Law 25/79, which provides for an agreement between the government and an investor. The Law of Contract governs contractual relationships, and a separate law (No. 4/79) governs business and trading activities by foreign nationals. Investment agreements are for an initial period of 5 to 10 years for investments less than \$1 million, and can be renewed thereafter. For larger projects, terms are negotiable.

Maldives began opening up to foreign investment in the late 1980s. Foreign investments in Maldives have primarily involved resort management, but also include telecommunications, accounting, banking, insurance, air transport, courier services, and some manufacturing. The Foreign Investment Services Bureau (FISB) www.investmaldives.org within the Ministry of Economic Development and Trade is tasked with promoting and regulating foreign investments in the country. The FISB reviews all proposed investments prior to granting licenses. The FISB offers "one-stop shop" services to investors and incentives including import duty concessions, 100 percent foreign ownership, no restrictions on repatriation of earnings or profits, and no foreign exchange restrictions. At present, personal income taxes are not imposed. Banks' profits are taxed and a corporate profit tax is under consideration for the end of the decade. International arbitration is available for dispute settlement.

The Government has said it is committed to improving the investment regime and approval process. Maldives is in the process of amending the FISB law with the help of the Foreign Investment Advisory Service (FIAS) of the World Bank group. Currently, approvals for new investments take about one month. In cases where the investment is similar to previously-approved foreign investments, immediate approval is frequently given.

The FISB encourages investment projects which: (1) are capital intensive; (2) enhance technology transfer; (3) introduce new skills and offer training to local employees; and, (4) are environmentally friendly. The FISB has identified the following industries as offering potential for foreign investors:

Tourism: Opportunities exist in the entire range of services, including development and management of resorts, tourist activities, and land and sea transportation.

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Value-Added Fisheries: Fish processing is open to foreign investment, particularly for new technology and capital investment.

Financial - banking, accounting, and management consulting: The FISB is interested in bringing in more global banks. (Only HSBC is currently present). The lack of adequate banking laws has deterred entry, however.

Transportation and Shipping: Development of air and sea transport including inter-atoll transport services, bunkering, transshipment, and passenger cruises. The development of a transshipment port in the northern Maldives targeting the rapidly growing transshipment traffic in the Indian Ocean is one of the government's highest priorities. The government is currently funding harbor-dredging projects for 103 islands on a contract basis. Other key priorities in the transport sector are the expansion of the Male? Airport, a bridge connecting the capital city Male? with the airport island Hulhumale, and a new commercial port in the Male? region.

Population Consolidation: There are two major development plans in the government's docket. The first is a consolidation of the services and infrastructure of 20 atolls around five regional centers. The second is a project to alleviate overcrowding in Male? by developing nearby Hulhumale Island, where Male?'s international airport is located.

Telecommunications and information technology also offer potential opportunities.

While infrastructure development remains a top priority for

the government, some of the projects listed above have been slowed as tsunami reconstruction work takes priority.

Retail trading is closed to foreign investment. The production of any items that are illegal to import into Maldives is prohibited.

--Conversion and Transfer Policies

There are no exchange controls or restrictions on currency movements. Repatriation of funds and profits is allowed after local debts are settled.

Major international currencies can be bought and sold at banks and authorized moneychangers. Hotels and banks accept major credit cards and travelers checks. Foreign currency accounts are available through banks. The US dollar is the most widely used foreign currency and is accepted by small shops and taxi drivers in Male?.

The official exchange rate is set at 12.8 Rufiyaa to the dollar. This rate has remained unchanged since 2001. The Maldivian currency is non-convertible and its true value cannot be determined. The Government has noted that it will need to review the exchange rate policy in the next few years in order to promote export diversification. The heavy dependence on imports is a constraint for exchange rate management, though tourism receipts help maintain hard currency liquidity. Large fiscal deficits financed by the Maldives Monetary Authority www.mma.gov.mv pose a potential threat to the fixed exchange rate system.

To improve public expenditure controls and management, the government has taken initial action to introduce a new public accounting system. A new public finance law came into force in January 2006. The Attorney General's Office is drafting a new public accounting bill and has already submitted an audit bill to the People's Majlis (parliament). There has been a delay in the passage of the audit bill. Instead, the President has issued several decrees on these subjects. Foreign reserves at the end of

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December 2006 were \$232 million, higher than end 2005 reserves of \$187 million, and were sufficient to finance 3.2 months of imports.

--Expropriation and Compensation

According to the Law on Foreign Investment (25/79) the Government may, with or without notice, suspend an investment, either where the investor indulges in an act detrimental to the security of the country or where temporary closure is necessary for national security. If, after due investigation, it cannot be concluded within 60 days of the temporary closure that the foreign investor had indulged in an activity detrimental to the security of Maldives, then the Government will pay compensation. Capital belonging to an investment that is closed for the above reasons may be taken out of the country in a mutually agreed manner. There appears to be little risk of expropriation in the near future.

--Dispute Settlement

The sources of law in Maldives are its constitution, Islamic Sharia law, regulations, Presidential decrees, international law, and English common law, with the latter being more influential in commercial matters. Although in November 2005, the government announced the creation of a 10-member Judicial Services Commission (JSC) responsible for nominating, dismissing, and examining the conduct of all judges, the JSC was not yet fully functional by the end of 2006. There is a High Court in Male? and lesser courts (the number to be determined by the President) in Male? and on other islands. There are no jury trials. The High

Court serves as court of appeal and also handles any politically sensitive cases. There are also eight lower courts in Male' dealing with theft, debt and property cases. Though legal procedures are adequate, the judicial process is slow.

Ultimate appeal may be directed to the President. In this process, the President is briefed by an advisory board, which goes through the appeal and recommends that the President affirm or overturn the decision of the High Court. Under a November 2005 Presidential decree, this advisory board was given some independence. The current constitution does not allow for an independent supreme court. A process of constitutional revision initiated in 2004 has not yielded results as yet.

The law on foreign investments guarantees the security of investments. Maldives has no laws pertaining to arbitration. Disputes involving investments below \$1 million can be referred to the courts in Maldives. Disputes over \$1 million can be referred for international arbitration.

Recognizing that the existing legal and commercial framework is underdeveloped and not always fully transparent or predictable, the government is promoting administrative reforms and formulating regulations dealing with labor, the environment and industry. In recent years, the People's Majlis has enacted a number of commercial laws, including the Law of Contract, the Negotiable Instruments of Law, and the Companies Act. Maldives is not a member of the International Center for the Settlement of Investment Disputes (ICSID).

--Right to Private Ownership and Establishment

There is little private ownership of land. Land reform currently under consideration may result in more trade and private ownership of property. Foreign investors are not allowed to own land, but are granted lease rights ranging up to 25 years, which can be later extended to 35 years for investments over \$10 million, or 50 years if 50 percent of the company's shares are floated on the Maldives stock

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market. Leases can be renewed at the end of their terms, but the formula for assessing compensation value of a resort at the end of a lease has not yet been developed. The government is looking at the possibility of extending the initial lease period from 25 years to 50 years.

--Protection of Property Rights

Maldives lacks specific legislation to protect intellectual property rights (IPR) and has not signed any related international agreements or conventions. Maldives benefits from the World Trade Organization (WTO) decision to extend the transition period for least-developed countries (LDC) to provide protection for intellectual property under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement until July 1, 2013.

--Efficient Capital Markets and Portfolio Investment

The financial sector in Maldives is narrow and dominated by the banking sector. The banking sector consists of one publicly owned commercial bank -- the Bank of Maldives -- and branches of four foreign-owned commercial banks. HSBC, the only global bank present, set up operations in 2002. Non-bank financial institutions in the country consist of two insurance companies, a pension fund, and a finance leasing company. All financial institutions currently operate under the supervision of the Maldives Monetary Authority, which acts as the central bank.

Local sources of finance are limited in scope because of

the small size of the capital market and the lack of instruments that are available in more developed nations. No financial instruments are offered to the public. The commercial banks provide short- and long-term credit to the private sector. No specialized financial institution exists to meet the investment needs of tourism, agriculture and fisheries. Non-performing loans are about 6 percent and the risk-weighted capital adequacy ratio is high. Most foreign currency loans are made to foreign currency-earning tourist enterprises. The Maldives Monetary Authority has introduced an emergency liquidity facility for commercial banks. Banking supervision has been recently upgraded, moving toward international best practices.

A small Securities Trading Floor (STF), opened in Male? in 2002 and performs the role of a stock exchange. In 2006, the government took several steps to enhance the capital market. The legislature passed a Securities Act in January 2006 and the government created a Capital Market Development Authority (CMDA) to regulate the capital market. The STF now functions under the CMDA. At present, the only investment opportunity available to the public is a limited number of shares in the Bank of Maldives and two other state-owned public companies. A leasing company, Maldives Finance Leasing Company (Pvt) Ltd (MFLC), was established in May 2002 as a collaborative venture between five domestic public and private sector entities and two international parties including the World Bank?s International Finance Corporation (IFC). The MFLC aims to address the demand for long-term equipment financing from all sectors of the economy. The Asian Development Bank will support strengthening the financial sector to more effectively mobilize savings and fund long-term development.

The Housing Development Finance Corporation is a government company designed to provide housing loans with long repayment terms at favorable interest rates. The company is also entrusted with drawing up the land use policy in Maldives.

--Political Violence

Maldives has a homogeneous society of one culture, one religion and one language. The current President has been

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in office since 1979. In 2004, the Government initiated a process of constitutional reforms to address calls for change and democracy. The President established a Special Majlis (a special parliament separate from the People?s Majlis) in May 2004 specifically to consider proposed amendments to the constitution. Elections in January 2005 brought some reformists into parliament. In June of 2005, Parliament legally recognized political parties.

Reformists complained that reform programs were slow and insufficient. Opposition groups held demonstrations to demand further reforms and request the release of political prisoners in August and November 2005 and January 2006. The demonstrations remained largely peaceful, although after the first such protest in August, several people were arrested and parliament was temporarily suspended. The arrested demonstrators were later released without charge.

--Corruption

In 2002, parliament passed a bill on the prevention and punishment of corruption. The law defines bribery and improper pecuniary advantage and prescribes punishments. The law also outlines procedures for the confiscation of property and funds obtained through commission of the included offenses. It broadens the mandate of the Anti-Corruption Board, which previously extended only to government employees, to investigate corruption in the private sector.

--OPIC and Other Investment Insurance Programs

Currently, the Overseas Private Investment Corporation (OPIC) does not operate in Maldives. Maldives is not a member of the Multilateral Investment Guarantee Agency of the World Bank Group.

--Labor

Skilled and unskilled labor can be scarce, and expatriate labor is allowed in order to meet shortages. There are an estimated 53,000 expatriate workers, mostly in tourism, construction, and social and personal services. Expatriate labor is equal to or more expensive than local labor. Even when salaries are set lower, travel and other benefits typically make it more expensive overall to hire expatriates.

Wages in the private sector are usually set by contract between employer and employee and are generally based on rates for similar work in the public sector. Employment contracts usually specify work hours on a weekly or monthly basis. Employees are usually authorized 20 days of annual leave, 30 days of medical leave, 45 days of maternity leave, and 10 days of special annual leave for "extraordinary circumstances." There are no laws governing health and safety conditions; however, there are regulatory requirements that employers provide a safe working environment and ensure the observance of safety measures.

Maldives is not a member of the International Labor Organization. Although unions are not expressly prohibited, the government does not recognize the right to form unions or the right to strike. Hence, labor actions and disputes are rare. The United States in 1995 suspended Maldives' eligibility for tariff preferences under the US Generalized System of Preferences (GSP) because the government failed to take steps to afford internationally recognized worker rights to Maldivian workers. The government has drafted new labor laws dealing with rights of association, the right to organize, and acceptable conditions of work, but passage of these laws has been delayed by ongoing legal review.

--Foreign Direct Investment Statistics

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Foreign Investment: US firms represented in Maldives include Western Union, FedEx, UPS, Hewlett Packard (HP), Dell, Compaq, Coca-Cola, American Express, Hilton Resorts, SeaTec, Ernst and Young, PricewaterhouseCoopers, and KPMG.

--Web Resources

Foreign Investment Services Bureau: www.investmaldives.org
International Monetary Fund: www.imf.org
World Bank: www.worldbank.org
Asian Development Bank: www.adb.org
Ministry of Planning and National Development:
www.planning.gov.mv
Maldives Monetary Authority: www.mma.gov.mv
Maldives Stock Market:
www.maldivesstockexchange.com.mv
United Nations Development Program: www.mv.undp.org

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